Housing Commission Status Update – State Housing Credit
August 3, 2006

Background

The current Virginia Housing Tax Credit program was enacted in 1989 at an authorized level of $3.5 million to provide supplemental support to properties receiving a federal Low-Income Housing Tax Credit allocation. However, for nine years the program was inactive due to lack of annual appropriations. Funding for the program was -finally budgeted in 1998. Nevertheless, the program was little used because most partnerships using federal Low-Income Housing Tax Credits are not Virginia corporations. The program regulations were revised in 2001 to enable individual members of a partnership to use the Virginia Housing Tax Credit. In addition, the program was restructured and modeled after the state historic tax credit. However, due to budget constraints, the amount of available state tax credits was reduced to $500,000.

Recently, there has been renewed interest in the Virginia Housing Tax Credit program as a means for addressing the subsidy needs of affordable rental housing developments. Land costs are becoming an ever larger share of total development costs, but land costs are not permitted to be included in the eligible basis used in calculating the federal Low Income Housing Tax Credit. The opportunity has been seen to restructure the Virginia Housing Tax Credit to enable it to be used to help write down the high cost of site acquisition. However, to be effective, this would also require a sizable increase in the annual amount budgeted for the program.

Status of Review of Alternatives

Original Community Housing Credit Proposal – A proposal for a $10 million Community Housing Credit was submitted to the General Assembly in January 2006, basically providing for a credit that equaled 50% of the actual amount expended by the developer to acquire land for a tax credit property. That amount was not to exceed $5,000 multiplied by the number of units of low-income housing, and would have been assigned to entities that had received an allocation of federal Low-Income Housing Tax Credits. The maximum per taxable year available to each developer was $500,000. Senate Bill 279 was left in the Senate Finance Committee and House Bill 1174 was carried over to the 2007 Session.

Revised Community Housing Credit based on North Carolina model – The North Carolina Housing Finance Agency (NCHFA) has developed and implemented an innovative state tax credit program based on the premise that the ownership structure of tax credit properties are pass-through entities (i.e., all federal and state income tax events such as profits, losses and credits pass through to the members or partners). Any tax credit made available to that ownership entity would then be of no use to it as there is no tax liability. Therefore, the NCHFA program is designed so that the credit can either be claimed directly by the pass-through entity (which is not a practical alternative) or can be transferred to NCHFA, which then makes a loan back to the ownership entity in the amount of the credit.

An in-depth study of the NC model reveals that it has been successful although it is based on a complicated methodology difficult for the general public as well as the parties involved to understand:

- State determines the total amount of credits available
- NCHFA allocates credits to the property-owning pass-through entity
- Pass-through entity transfers the credit amount to NCHFA
- NCHFA receives tax refund (in lieu of credit) from NC Department of Taxation
- NCHFA lends the tax refund amount to the owning entity
- Owning entity uses the loan amount as equity for developing the property

Pros:
NC's previous state credit regulations did not allow bifurcation (i.e., sale to a party other than the federal tax credit investor), so the market for purchase by persons/corporations with in-state tax liability was saturated. The refunding tax credit allowed NC to continue providing funding. Although Virginia's state tax credit currently allows bifurcation, the NC method provides more control over the credit amount, ends the need for a secondary syndication and allows for a quick turn-around for the loan option.

Cons:
Adoption of the NC method would require obtaining an IRS private letter ruling affirming the VHDA loan of the tax credit would not be a taxable event, and there is some uncertainty whether the ruling should be obtained before or after legislation. There would be additional administrative complexity in the funding, allocation and monitoring aspects of the program.

Alternate Proposal – Land acquisition subsidies could be most efficiently provided through a direct loan/grant program. Creation of a state Housing Trust Fund financed through an allocation from the real estate transfer tax is currently being proposed by the Virginia Housing Coalition. Such a Trust Fund would be sufficiently large to serve as a means to directly fund land acquisition loans or grants for tax credit developments. However, this would require setting aside a portion of the Trust Fund specifically for soft-second financing for developments receiving federal Low Income Housing Tax Credits.

Pros:
The creation of a Housing Trust Fund coupled with a tax credit land-acquisition component would streamline program administration and achieve a greater impact from the same level of state expenditure than use of tax credits for investment entities.

Cons:
The General Assembly has not yet committed to the concept of a state Housing Trust Fund.